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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

MEMORANDUM TO: Donna L. Searcy
Secretary

FROM: Office of Commissioner Duggan

RE: Ex Parte Filings in Unrestricted Rulemaking Proceeding

DATE: January 19, 1993

Please include the attached letter in the record of CC Docket No. 92-101.

Attachments

No. of Copies rec'd 0+1
List A B C D E

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January 13, 1993

Commissioner Ervin S. Duggan
Federal Communications Commission
1919 M Street, NW, Room 832
Washington, DC 20554

Dear Commissioner Duggan:

We are very concerned by the delay in the Commission's decision regarding exogenous cost treatment by local exchange carriers (LECs) for the accrual of future post employment benefits (OPEB) under SFAS 106. As a result of this delay, the Commission has allowed access rates based on OPEB to go into effect subject to an accounting order and we, as captive access purchasers, are forced to pay these higher rates amounting to a total of $79 million for the industry. We fully expect that the Commission's delay in this matter will encourage other LECs to file for OPEB exogenous treatment.

Based on information filed by the LECs in this proceeding, we estimate that the total industry access increase could be over $300 million for all long distance companies. Such a cost structure increase will result in substantial price increases for end user customers.

Although the position of AT&T and MCI in this matter differ somewhat, we agree that the record is devoid of facts sufficient to meet the LECs burden of proof that the amount of OPEB exogenous cost treatment requested is lawful. We both have demonstrated that the studies the LECs have used to justify their increases are not credible because, among other things, the premises on which conclusions are based are inaccurate and/or unsupported. It is clear, therefore, that the Commission must reject the tariffs as filed and order appropriate refunds to carriers.

We urge you not to be swayed by the concerted campaign on the part of the LECs to pressure the Commission to make a patently unlawful and unwise decision to allow the OPEB exogenous treatment requested by the LECs.

Sincerely,

AT&T

By: T H Norris
Thomas H. Norris
Vice President Federal Regulatory Affairs

MCI Communciations

By:
James L. Lewis
Vice President Regulatory & Public Policy

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EX PARTE

United States Telephone Association

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(202) 835-3100

January 14, 1993

Chairman Alfred C. Sikes
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: CC Docket No. 92-101

Dear Chairman Sikes:

Over the past several weeks, MCI has circulated a number of different ex parte letters seeking to influence the application of the Commission's rules to SFAS 106 exogenous treatment by price cap exchange carriers (LECs). Because we find significant errors or incorrect representations in these letters, USTA is filing this written response, which covers all of the recent MCI ex parte letters of which we have become aware.

There are myriad claims that are included in the letters. Most are not directly related to this proceeding at all, but appear to be included simply to amplify the few direct arguments MCI is restating.

The single claim that runs through each letter is that, because postretirement benefits themselves "were incurred by the LECs as a result of decisions made during wage negotiations," the adoption of SFAS 106 and its ramifications therefore could not constitute an exogenous event.[1] MCI claims that exogenous treatment is not merited because MCI has concluded that benefit levels themselves were under the carrier's control. MCI misunderstands or simply misstates the issue. The central issue here is the fact that carriers have been mandated to change their method of accounting for OPEBs, and that the new accounting requirement forces OPEBs costs to be recognized on a different basis. It is the mandated accounting change that is the exogenous event. The price cap LECs had no control over the event which has required them to implement accrual accounting for OPEBs. The Financial Accounting Standards Board (FASB) and the Commission have made SFAS 106 mandatory.

MCI also incorrectly states that the accounting change is focused primarily on future costs, stating: "what has changed is the method of recognizing future costs."[2] MCI also implies that SFAS 106 has not changed actual costs. These statements are deceptively

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[1] See, e.g., MCI ex parte, January 6, 1992, from D. Evans at 1.

[2] See MCI ex parte, January 6, 1993, from D. Evans at 1.

incomplete. SFAS 106 costs are real costs of doing business that have been incurred by the carriers, and represent cash obligations that SFAS 106 now requires be recognized.

Just as the Commission has concluded in other contexts that current ratepayer costs should not be paid by future ratepayer groups, SFAS 106 requires that current costs of providing OPEBs be recognized in the current period, rather than delayed. The preexisting rule provided for a pay-as-you-go arrangement, whereby a carrier would recognize expenses actually incurred in previous periods only at the time they are paid. The FASB and the Commission have already concluded that this failed to reflect the true economic cost of OPEBs. The Commission has adopted SFAS 106 accounting.

Under preexisting accounting rules and rate of return regulatory constraints, the price cap LECs' OPEBs costs were postponed into the future, significantly understating the true cost of OPEBs. This resulted in prices to customers that were lower than required to cover the benefit obligations to employees working for the carriers at that time. Of course, SFAS 106 provides for ongoing recognition of costs as they are incurred. However, it also requires prior costs already incurred be recognized, causing real financial impacts now. SFAS 106 is being implemented across the business spectrum; there is no special consideration that could prevent LECs from doing the same. MCI and others who are outside comprehensive regulation have wide discretion to recover the true cost of OPEBs on a continuing basis in the prices they set. In contrast, the LECs under rate of return regulation and pay-as-you-go accounting for OPEBs had prices established using amounts below the actual cost of OPEBs; the prices of service now are simply being reconciled as these costs are taken into account under SFAS 106. Exogenous treatment of OPEBs cost that now should be recognized would not necessarily lead to an increase in revenue. Each price cap LEC must address its own price and market constraints.

MCI incorrectly asserts that the price cap LECs are requesting "relief from the very method of regulation that they advocated."[3] Actually, it is MCI which seeks to revise the rules to force OPEBs into the endogenous category of costs. That is why it has made its arguments here, however thin they are. The price cap rules and orders establish criteria for exogenous treatment. The price cap LECs contend that the handling of OPEBs as exogenous is a straightforward application of those Commission directives.

Certainly, the FASB had OPEBs accounting under consideration for an extended period of time. USTA and the price cap LECs were aware that accrual accounting for OPEBs could be required at some point. They argued to the Commission that exogenous treatment of accounting changes was an essential element of a fair regulatory plan. The

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[3] See MCI ex parte, December 17, 1992, from D. Akerson at 1.

Commission concluded in adopting the price cap rules that "recognition of changing costs in adjustments to price caps is necessary to ensure that rates are not unreasonable from both a carrier's and the ratepayer's perspective."[4] Part 61.45 (d)(1) of the Commission's Rules allows for exogenous treatment of accounting changes as the Commission shall permit or require, and its Rules also provide for tariffs to address them when the changes are introduced. Thus, the price cap LECs are not requesting a change in price cap rules. In contrast, MCI apparently wants a redefinition of the exogenous cost mechanism so it will recognize only reductions in price cap indexes. The existing Commission Rules, however, contemplate both increases and decreases to price cap indexes. MCI bears a heavy burden to show that a new rule should be adopted to disallow costs that FASB 106 and the USOA require be recognized by the price cap LECs now.

MCI incorrectly suggests that "if the Commission allows exogenous treatment of post retirement benefits because the 'full' impact on each individual LEC is not reflected immediately in GNP-PI," the Commission must unbundle the entire GNP-PI.[5] MCI misunderstands the Commission's rationale for using GNP-PI inflation as an adjustment to the price cap indexes (and also the LECs' examination of GNP-PI in this docket.)[6] Growth in GNP-PI represents general inflation in the U.S. economy. It is used in the price cap framework because the prices of normal inputs used by carriers rise with the overall inflation rate. GNP-PI was selected by the Commission because it is a broad and conservative measure of inflation that could be expected to adequately reflect it in the price cap formula. The Commission recognized that GNP-PI would not capture all events affecting the prices of carriers' inputs; the exogenous cost framework exists in part to deal with these other effects. SFAS 106 costs are not accommodated in the normal GNP-PI framework. MCI is stretching for offsetting adjustments in claiming that LECs do not purchase certain goods or services that are reflected in GNP-PI. MCI provides no basis for reevaluating specific parts of GNP-PI within the context of the price cap formula.

Finally, MCI incorrectly implies that the LECs should record the difference between SFAS 106 costs and pay-as-you-go costs as a regulatory asset. The Commission must reject this demand. The Commission has already ordered SFAS 106 costs be reflected on

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[4] Further Notice, CC Docket No. 87-313, at ¶ 336.

[5] See MCI ex parte, January 6, 1993, from D. Evans at 2.

[6] It was in response to specific Commission orders that the price cap LECs undertook an examination of the GNP-PI to determine the extent, if any, of a possible double-counting of the exogenous recovery using the existing price cap mechanism. See, for example, Order on Reconsideration, CC Docket No. 87-313, released April 17, 1991, at ¶ 63; and Order of Investigation and Suspension, CC Docket No. 92-101, released April 30, 1992, at ¶¶ 11, 15 and 16.

the income statement, not recorded as a regulatory asset. Also, the Emerging Issues Task Force (EITF) of the FASB has already concluded that unless a regulator provides future revenue at least equal to the deferred cost (regulatory asset), the establishment of a regulatory asset will not be allowed.[7] This MCI suggestion contradicts generally accepted accounting principles.

The other claims that appear in the MCI letters repeat themes that appear in MCI filings in other proceedings, but that are essentially irrelevant here. MCI attempts to leverage claims that LECs face less competition, suggestions to take the expenses below the line, and requests for a broad access price review, all without substantiation, presumably to obtain offsetting cost reductions. The Commission has already concluded that SFAS 106 accounting is consistent with the Commission's regulatory accounting needs.[8] MCI's other demands contain no facts that are germane to exogenous treatment of SFAS 106 costs.

We believe these late MCI arguments are meritless. If there are any questions on this issue, we would be happy to respond. Two copies of this written ex parte response are being filed with the Secretary today for filing in the docket file of this proceeding.

Respectfully submitted,

Martin T. McCue

ccs: Commissioners
Commissioner Legal Assistants
Cheryl Tritt, Chief, Common Carrier Bureau
Greg Vogt, Chief, Tariff Division
Mary Brown

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[7] Minutes of the November 19, 1992 EITF Meeting at 3. EITF minutes are a matter of public record. The EITF established other requirements before a regulatory asset could be established, including: annual SFAS 106 costs (including the TBO) should be included in rates within five years of adoption of SFAS 106; and the combined deferral/recovery period should not exceed approximately 20 years.

[8] Order, AAD 91-80, released December 26, 1991. "After reviewing SFAS-106, we have concluded that adoption for accounting purposes will not conflict with the Commission's regulatory objectives." at ¶ 3. Also, RAO Letter 20, released May 4, 1992, dictates how carriers account for SFAS 106.